

BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Investigation on the Commission's Own Motion into the Merger,
Combination, Reorganization of WPS Resources Corporation and
Peoples Energy Corporation

9405-YI-100

FINAL DECISION

This is the Final Decision in the Commission's review of the merger, combination, reorganization of WPS Resources Corporation and Peoples Energy Corporation. The transaction is approved subject to conditions.

Introduction

The Parties to the Transaction

WPS Resources Corporation (WPSR), a Wisconsin corporation, is a holding company with five major energy-related subsidiaries: Wisconsin Public Service Corporation (WPSC); Upper Peninsula Power Company (UPPCo); Michigan Gas Utilities Corporation (MGU); Minnesota Energy Resources Corporation (MERC); and WPS Energy Services, Inc. (ESI). These subsidiaries provide electric and natural gas energy and related services in both regulated and non-regulated energy markets. WPSR's regulated operations serve customers in Wisconsin, Michigan, and Minnesota, and its non-regulated businesses service customers primarily in the northeastern United States, Texas, and Canada. WPSR has several other, less substantial subsidiaries.

Peoples Energy Corporation (PEC), an Illinois corporation, is a holding company with four primary business segments: gas distribution; oil and gas production; energy assets; and

energy marketing. Its gas distribution segment includes two regulated Illinois distribution companies, Peoples Gas Light and Coke Company (Peoples Gas) and North Shore Gas Company (North Shore). PEC also owns an energy marketing business and an oil and natural gas production company. Other subsidiaries of PEC own interests in generating assets, which PEC is in the process of divesting in connection with exiting this business segment. PEC has a number of less substantial subsidiaries.

The Transaction

WPSR will acquire PEC in a stock-for-stock exchange. WPSR will be the surviving entity; PEC will become a wholly-owned subsidiary of WPSR.¹ The PEC holding company system, in its entirety, will become a sub-holding company system² within WPSR. The new combined holding company will change the WPSR name to Integrys Energy Group (Integrys) and will relocate the holding company headquarters to Chicago, but will remain incorporated in the state of Wisconsin. All of the utilities within the new combined holding company system will retain their current names and headquarter locations and will continue as regulated public utilities within their respective jurisdictions and service territories. After the merger closing WPSR's and PEC's energy marketing businesses will be combined, renamed and headquartered in the Green Bay area.

The Procedural Process

On July 8, 2006, WPSR and PEC signed an Agreement and Plan of Merger. On August 9, 2006, the Commission opened a docket and issued a notice of investigation on its own

¹ Each PEC common share outstanding immediately prior to the reorganization will be converted into 0.825 shares of WPSR's common stock. This exchange rate will result in a premium to PEC shareholders.

² The PEC holding company system (PEC the parent and all of its subsidiaries) will remain intact. WPSR will be the ultimate head or parent of that system.

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motion to consider any and all effects of the merger, combination, reorganization of WPSR and PEC on the existing holding company, WPSR, and its subsidiaries, specifically WPSC including but not limited to jurisdictional and approval authority. On August 15, 2006, WPSC filed for approval of amendments to affiliated interest agreements and for a waiver of the Natural Gas Standards of Conduct for regulated gas marketing affiliates. The Commission docketed WPSC's affiliated interest request as docket 6690-AU-112. The affiliated interest approvals are sought in connection with the series of transactions set forth in the Agreement and Plan of Merger between WPSR and PEC. WPSC intends to amend its master service agreements to add the PEC subsidiaries as parties.

On August 30, 2006, the Commission filed a Notice of Intervention in the Federal Regulatory Commission (FERC) proceeding relating to this merger proposal; docket EC06-152-000.

On September 27, 2006, the Commission issued a notice of prehearing conference stating that upon initial review, the Commission re-noticed this matter as a contested case proceeding and directed a hearing under Wis. Stat. §§ 196.02, 196.52, 196.795, and 196.80 to review issues related to this merger. In addition to determining the issues and parties to this proceeding, the October 10, 2006, prehearing established a two-pronged approach. In order to facilitate WPSR and WPSC's request to expedite this proceeding, the Commission hosted three settlement conferences in addition to establishing a hearing schedule. While the settlement conferences did not achieve an agreement, they did facilitate a dialog delineating the issues and possible conditions.

On January 18, 2007, pursuant to due notice, a hearing was held under Wis. Stat. §§ 196.02, 196.52, 196.795, and 196.80, at Madison before Administrative Law Judge Kevin Cronin. The parties, for purposes of review under Wis. Stat. §§ 227.47 and 227.53, are listed in Appendix A.

Findings of Fact

1. WPSC is a Wisconsin corporation that provides regulated electric and natural gas utility service to more than 425,000 electric customers and 308,000 natural gas customers in northeastern and north central Wisconsin and a portion of Michigan's Upper Peninsula.
2. UPPCo is a Michigan corporation providing regulated electric service to approximately 52,000 customers in Michigan's Upper Peninsula.
3. MGU is a Delaware corporation providing regulated natural gas service to approximately 161,000 customers in lower Michigan.
4. MERC is a Delaware corporation that provides regulated natural gas service to more than 200,000 customers throughout Minnesota.
5. ESI is a Wisconsin Corporation and WPSR's major non-regulated subsidiary. ESI is a non-regulated energy supply and services company serving commercial, industrial and wholesale customers, as well as aggregated groups of residential customers. ESI's operations are in Illinois, Maine, Michigan, Ohio, Texas, Virginia, and Wisconsin in the United States, and Alberta, Ontario, and Quebec in Canada, while its principal markets are the northeastern quadrant of the United States and adjacent portions of Canada. ESI owns and/or operates non-regulated electric generation facilities in Wisconsin, Maine, Pennsylvania, New York, and

New Brunswick, Canada; steam production facilities in Arkansas and Oregon; and a partial interest in a synthetic fuel processing facility in Kentucky.

6. Peoples Gas, an Illinois corporation, is an Illinois public utility providing regulated natural gas service in the city of Chicago. Peoples Gas serves approximately 830,000 customers.

7. North Shore, an Illinois corporation, is an Illinois public utility providing regulated natural gas service to approximately 155,000 customers in 54 communities in northeastern Illinois.

8. Peoples Energy Services Corporation (PESC) is an Illinois corporation engaged in non-regulated energy marketing. PESC furnishes retail energy services to more than 31,000 customers in Illinois, Michigan, and Ohio, providing a portfolio of products to manage energy needs of business, institutional and residential consumers. PESC has obtained authorizations to expand its services into Ohio and New York.

9. Peoples Energy Production Company (PEP) is a Delaware corporation engaged in oil and natural gas production. PEP primarily focuses on acquiring proven, onshore reserves with upside potential in a limited number of strategic supply basins, to which value can be added through drilling programs, production, enhancements, and reservoir optimization. PEP's acquisition and drilling efforts concentrate primarily on natural gas.

10. Peoples Energy Resources Company, LLC (PERC) is a Delaware limited liability company that owns several subsidiaries involved in various wholesale gas businesses, natural gas liquids businesses, and power generation development. PERC and its subsidiaries are in the process of disposing of their interests in power generation assets and exiting this business.

11. The conditions proposed in this Final Decision are reasonable and necessary to protect the public interest.

12. It is reasonable to modify the 6690-UR-118 Final Decision provision for a 2008 fuel rules reopener to include known changes for 2008 coal and rail costs.

13. It is reasonable that neither net merger costs nor benefits be factored into the return on equity (ROE) calculation for 2007 and 2008 for the purpose of determining excess revenues under Wis. Admin. Code § PSC 116.07(6).

Conclusions of Law

1. WPSR is a holding company as defined in Wis. Stat. § 196.795.
2. Integrys will be a holding company as defined in Wis. Stat. § 196.795.
3. WPSC is a public utility as defined in Wis. Stat. § 196.01.
4. The Commission has authority under Wis. Stat. §§ 196.02, 196.06, 196.09, 196.21, 196.395, 196.52, 196.79, and 196.795 to grant its consent and approval of a series of interrelated transactions involving PEC and its affiliates and WPSR and its affiliates resulting in a merger and to issue this Final Decision.
5. The Commission has authority under Wis. Stat. §§ 196.02, 196.395, 196.79, and 196.795 to condition the series of interrelated transactions resulting in the proposed merger.

Opinion

Jurisdiction

In the application, WPSR/WPSC stated that the Commission does not have approval authority over the merger under Wis. Stat. §196.80. Wis. Stat. §196.80(1m)(a) states, “With the consent and approval of the commission but not otherwise a public utility may: (a) Merge or

consolidate with one or more other public utilities.” WPSR/WPSC argues that because WPSC is the only “public utility” in the corporate family and no other “public utility” within the meaning of Wis. Stat. §§ 196.01(5)(a) and 196.80(1m) is a party to the merger and no other “public utility” will be a member of the combined holding company system, no approval is required under Wis. Stat. § 196.80. In its initial briefs WPSR/WPSC states that the Commission did not require or apply Wis. Stat. § 196.80 in the WPSR – UPPCo merger, docket 3270-DR-102, and the Wisconsin Energy Corporation – WICOR merger, dockets 9401-YO-100 and 9402-YO-101. WPSR/WPSC stated that in the event the Commission concluded as a legal matter that Wis. Stat. § 196.80 does apply that the merger should be approved unconditionally and found in the public interest. WPSR/WPSC noted in the application that they applied for this approval in the alternative, reserving their rights to seek judicial review of the Commission’s determination as to its authority under Wis. Stat. § 196.80.

The Citizens’ Utility Board (CUB) takes the position that Wis. Stat. § 196.80 does apply because, in substance, the proposed transaction is a merger between public utilities. CUB notes that the term “merge” is not defined in Wis. Stat. ch. 196, nor does Wis. Stat. § 196.80 state whether a merger must be direct or indirect to be covered by the statute. CUB states that under corporate law, when entities “merge,” there is generally an amalgamation of two corporations in which one of the corporations survives and the other disappears.³ Under the proposed transaction PEC will become a wholly-owned direct subsidiary of Integrys (WPSR). WPSC will be a wholly-owned direct subsidiary of Integrys and Peoples Gas and North Shore will be wholly-owned indirect subsidiaries of Integrys. Because of the common ownership and control

³ Black’s Law Dictionary, p. 988 (6th ed. 1990)

by Integrys, CUB believes the transaction results in the indirect merger of Peoples Gas, North Shore and WPSC. CUB notes that prior to the passage of the Energy Policy Act of 2005, which clarified FERC's jurisdiction over the merger of holding companies that own public utilities, FERC had concluded that when public utility holding companies merge, an indirect merger involving their public utility subsidiaries also takes place.⁴ While the utilities will all retain separate identities in the proposed transaction, they will be unified under the common ownership and management of Integrys. Furthermore, the holding company system, including the three utilities, will utilize a service company – consolidating administrative and general as well as some operational functions to assist in achieving synergy savings.

CUB cites the Alliant merger, docket 6680-AU-100, and its application of Wis. Stat. § 196.80. CUB believes that in the era of multi-state utility holding companies, the Commission should interpret the meaning of public utility broadly in order to cover transactions such as the one proposed here. CUB also notes that this Commission need not follow the decision in docket 3270-DR-102 and that the Commission enumerated Wis. Stat. § 196.80 as a basis for jurisdiction in its Notices in this matter.

WPSR/WPSC, in various filings, describe the proposed transaction as a reorganization, combination (consolidation) and/or merger depending on the venue. Reorganization, consolidation and merger are not statutorily defined, permitting the application of the plain meaning of those terms under the affected statutes (Wis. Stat. §§ 196.79 and 196.80).

Interpretation using the ordinary meanings of reorganization, consolidation and merger satisfies the intent of the legislature and the remedial purpose of the statutes. The Commission concludes

⁴ See *Order on Rehearing*, FERC Docket No. RM05-34-001, 115 FERC ¶ 61, 097 P 55 (April 24, 2006); 16 U.S.C. § 824b(a)(1)(B) (2006); *Illinois Power Company*, 67 FERC ¶ 61,136 (1994).

concludes that Wis. Stat. §196.80 does not apply to this transaction. Under current state law, this statute applies to the merger of Wisconsin “public utilities”—not the acquisition by a Wisconsin holding company of an out-of-state public utility holding company that includes two public utilities that are incorporated in the state of Illinois. Under a plain reading of the definition of “public utility” in Wis. Stat. § 196.01(5), the Illinois utilities (Peoples Gas and North Shore) are not considered “public utilities” under Wisconsin law.

The Commission declines CUB’s invitation to construe this statute so broadly as to invoke the Commission’s authority under Wis. Stat. § 196.80 in this proceeding. The Commission is not persuaded that its authority under this statute is invoked by the “indirect merger” of Peoples Gas and North Shore with a Wisconsin utility, WPSC, as a part of the proposed combination of two holding companies. That finding, if adopted, would also be contrary to the Commission’s interpretation of this statute in prior proceedings that concluded that a merger only results from the combination of at least two public utilities operating in Wisconsin—not in an out-of-state utility that provides no service in our state.⁵

The Commission finds that it has sufficient authority to review these applications and to condition its Final Decision under other statutory provisions, including Wis. Stat. §§ 196.02, 196.395, 196.52, 196.79, and 196.795.

⁵ *Petition for Declaratory Ruling of MGE, Wis. Pub. Power, and Wisconsin Municipal Intervenors, 3270-DR-102 (Wis. PSC Sept. 2, 1998).* That declaratory ruling discussed and distinguished the Wisconsin Power and Light Company merger case, *Joint Application of WPL Holdings, Inc.*, docket 6680-UM-100, (Wis. PSC Nov. 5, 1997). In the *WPL* proceeding the applicants filed under Wis. Stat. § 196.80, and the Commission cited the statute in its conclusions of law. However, the Commission did not appear to rely on that statute when issuing its final decision and did not find the Iowa utilities to be “public utilities” as defined in Wis. Stat. § 196.01(5). Instead, it determined the Iowa utilities involved in the merger were “public utility affiliates” as defined in Wis. Stat. § 196.795(1)(L) only for the purpose of calculating the asset cap under the holding company statute. (See Findings of Fact, Conclusions of Law and Order, docket 6680-UM-100, Conclusion of Law #3 at page 49, cited in Findings of Fact, Conclusions of Law and Order, docket 3270-DR-102, at page 9.)

Rate Restriction Proposal

Commission staff proposed a WPSC rate restriction as a condition for authorization for the merger. Commission staff's proposal in this proceeding is, not by strict definition, a rate freeze. Instead of prohibiting a rate change, it substantially limits WPSC's ability to seek a rate increase for 2008. Consistent with the Commission's recent rate order for WPSC in docket 6690-UR-118, WPSC will be allowed to seek rate recovery for 2008 gas-related fuel costs. Under this proposal, the Fuel Rules in Chapter 116 of the Wisconsin Administrative Code will also be in effect for 2007 and 2008 and have the ability to generate rate increases or decreases. Issues associated with the Midwest Independent System Operator (MISO) Day 2 costs will be addressed in docket 05-EI-139, for which hearings are scheduled in February, 2007. The outcome of that proceeding will determine the accounting and ratemaking for those costs.

WPSC testified that its forecasted cost of delivered coal in 2008 is now significantly higher than in earlier forecasts. In addition, the Commission has recently ordered the termination of escrow accounting for ATC network charges. These changes or events increase the estimated costs during the proposed rate restriction period. Additionally, the rate restriction proposed by WPSC in the rate case was not mandatory in nature, while it would be in this docket. WPSR/WPSC indicated they would accept the rate restriction condition if it was further modified to allow coal and rail costs to be reflected in WPSC's updated 2008 monitored fuel costs and the January 1, 2008, step rate change. WPSR/WPSC also requested that ATC network charges either be included in the January 1, 2008, step rate change as an adjustment for increased demand charge rates or it be allowed to defer the 2008 increase for future recovery.

It is reasonable that the rate restriction condition be modified to permit known increases in coal and rail costs to be reflected in WPSC's updated 2008 monitored fuel costs and the January 1, 2008, step rate change. It is not necessary to address potential 2008 increases in demand charge rates associated with ATC network charges in this proceeding.

Fuel Rules Calculations

Commission staff proposed and WPSR/WPSC agreed that net merger costs would not be factored into the return on equity (ROE) calculation for 2007 and 2008 if such an excess earnings test is made under the Fuel Rules. This prevents WPSC from avoiding a possible refund of any fuel-related surcharge because it had merger costs, thereby lowering its earned ROE. Similarly, it is appropriate to exclude any net merger costs or benefits from the calculation of earned ROE in 2008. This incents the utility to minimize merger costs and maximize merger benefits and does not unfairly prevent or create fuel cost-related refunds during the period.

The briefs of Wisconsin Industrial Energy Group, Inc. (WIEG) and CUB argue that this proposal violates the fuel rules established in Wis. Admin. Code ch. PSC 116 and is therefore unlawful.

It is reasonable that neither net merger costs nor benefits be factored into the ROE calculation for 2007 and 2008 for the purpose of determining excess revenues under Wis. Admin. Code § PSC 116.07(6). Net merger costs are the transition costs (costs-to-achieve) and related synergy savings. Transaction costs are not recoverable in rates in any context and therefore are not part of the net merger cost calculation. As such, transaction costs are excluded from any excess earnings test under the fuel rules.

Holding Company Principles

The Commission is guided by the following principles, which were incorporated by the legislature in the act which created the holding company statute:

1. Utility ratepayers shall not be made worse off in any way by the formation and operations of the holding company.
2. Utility ratepayers should benefit from the activities of the holding company, at least indirectly, as taxpayers and community members.
3. Non-utility operations of the holding company or its non-utility subsidiaries should not be regulated.
4. The formation and operation of the holding company shall in no way diminish the Commission's authority over the utility.

Wis. Stat. § 196.795(2)(e) specifically provides that the Commission may impose "terms, limitations or conditions" which are consistent with and necessary to satisfy the terms of Wis. Stat. § 196.795(5)(b) to (s), at the time of approval of the formation of a holding company. Wis. Stat. § 196.795(2)(f) specifically provides that at any time subsequent to the time the Commission approves the formation of a holding company under paragraph (e), the Commission may modify any "term, limitation or condition" imposed under paragraph (e) or add any limitation, term or condition under (e) which are consistent with and necessary to satisfy the terms of Wis. Stat. § 196.795(5)(b) to (s).

The following conditions are consistent with and necessary to satisfy the terms of Wis. Stat. § 196.795(5)(b) to (s):

Merger Transaction and Transition Costs and Synergy Savings Conditions

1. The applicants shall expense the cost to achieve the merger as incurred. WPSC may not recover any merger-related transaction costs from the Wisconsin retail jurisdiction.

Merger-related transaction costs include all of the following:

- a. Amounts paid to investment banks for assistance in transaction structuring and negotiation and the provision of fairness opinions – estimated at approximately \$20.5 million.
- b. Payments and other compensation to executives provided under change of control agreements – estimated at approximately \$15.3 million.
- c. Directors and officers tail insurance coverage – estimated at approximately \$2.9 million.
- d. Regulatory process and compliance costs – estimated at approximately \$10.5 million.
- e. Internal/external communications costs – estimated at approximately \$2.75 million (total estimated at \$5.5 million).

All transaction costs incurred by or allocated to WPSC shall be specifically identified and allocated to non-utility accounts.

2. WPSC may recover merger-related transition costs from the Wisconsin retail jurisdiction, but only if and to the extent such costs are (a) incurred by or allocated to WPSC (WPSC's portion/share of merger-related transition costs); (b) associated with financial benefits that WPSC's ratepayers will receive as a result of the merger; and (c) WPSC's merger-related savings realized are equal to or greater than its merger-related transition costs.

3. WPSC shall identify and track all merger-related transition costs incurred by it and allocated to it in a manner that is readily reviewable and auditable by the Commission at a location within Wisconsin.

4. In any proceeding in which recovery, analysis and/or justification of merger savings is at issue, WPSC shall provide a detailed analysis of merger costs and savings for Commission review and approval. The analysis shall include all of the following:

- a. An accounting of merger costs incurred by the combined company broken down by function to the extent possible.
 - b. A calculation of merger savings accomplished by the combined company.
 - c. Where costs exceeded savings for a particular function, a demonstration that the costs were reasonable and prudent.
5. The allocations of merger-related transition costs to WPSC shall be filed by and reviewed by the Commission in a separate affiliated interest docket. The Commission shall have approval authority over all allocation methodology and factors. If the allocation methodology and factors ultimately approved by the Commission differ from those approved in other jurisdictions, Integrys (the parent holding company) will absorb any cost differentials.

Service Quality Condition

6. WPSC shall maintain service quality and file any reports in this regard that may be developed or required by the Commission.

Affiliated Interest – Service Company Conditions

7. Within 120 days after closing, WPSC will apply for the Commission's approval under Wis. Stat. §§ 196.52 and 196.795(5)(r) and (s) of the affiliated interest transactions and agreements associated with a service company. With the application, WPSC will file its plan and schedule of operation after all federal, state and local regulatory approvals of the service company are received. The parent holding company shall not elect to have the FERC review pursuant to Section 1275 of the Energy Policy Act of 2005, 42 U.S.C. § 16462, the allocation of costs for goods and services provided by the service company, until the Commission has reviewed and taken action on the affiliated interest transactions and agreements associated with the service company, or amendments thereto. If the Commission has not completed its review

and approval within a reasonable time after the Commission determined an amendment to the service company agreement complete, the parent holding company may seek such FERC review after giving the Commission 60 days' prior written notice.

8. The Commission shall have full access to the books and records of the service company as provided in Wis. Stat. §§ 196.52 and 196.795(5)(b). This access shall be readily available in Wisconsin.

9. The service company shall be limited to performing services where there are efficiencies and economies of scale that could not be achieved if the services were not performed by the service company. If, in the future, Integrys and/or any of its subsidiaries are down-sized in any significant way, the absolute cost allocation to WPSC shall not increase unless WPSC demonstrates that the cost allocation is just and reasonable. In its performance of services, the service company (a) shall follow applicable federal and state regulations, including codes and standards of conduct, with respect to the sharing of confidential information the service company receives from one subsidiary with another subsidiary; (b) shall not give one or more entities in the corporate structure a competitive advantage in relevant markets; (c) shall not subsidize WPSC or cause WPSC to subsidize an affiliate; and (d) may include a return on its net assets at a rate no higher than the prevailing weighted cost of capital for WPSC.

10. The service company may not provide services to companies that are not part of the holding company system without the Commission's approval, except that the service company may provide the services that WPSR and WPSC are currently providing to third parties (and Integrys, any sub-holding companies, and WPSC may continue to provide such services until the service company is operational), and the service company may temporarily provide

transition services to an entity that is transferred to a third party. The service company shall apply any earnings as a deduction to the amounts reimbursable by its associated affiliates.

Affiliated Interest Condition

11. WPSC shall file new affiliated interest agreements for new qualifying relationships and all current agreements that will have changes to the names or services after the merger. This includes, but is not limited to, inter-company guarantees and lending arrangements, information sharing, technology, gas portfolios, etc.

Holding Company Conditions

12. Integrys Energy Group, Inc. shall be subject to all applicable requirements of Wis. Stat. ch. 196 and to all of the conditions and requirements in any Commission order relating to WPS Resources Corporation, including, but not limited to, the holding company formation order, docket 9405-YI-100.

13. Integrys and its subsidiaries shall provide the Commission with prompt notice of any filing made with the Illinois Commerce Commission (ICC) and FERC that is relevant to the Commission's authority and obligations.

Access to Records Condition

14. All books and records of all entities in the corporate structure shall be readily available for Commission staff review in a reasonable manner, subject to approval by the Commission.

Capital Structure and Dividend Payment Conditions

15. WPSC shall operate within its long-range common equity range, and in accordance with its common equity target, as established in its rate proceedings. No goodwill created by the merger shall be transferred to WPSC's books.

16. Integrys is subject to, among other statutory provisions, Wis. Stat. §§ 196.795(5)(g) and (5)(i), which protect utility ratepayers from the financial impacts of non-utility activities. WPSC agrees to hold ratepayers harmless from any increased costs of debt and preferred stock demonstrated to be attributable to non-utility activities. For rate setting proceedings, this may include imputing costs of debt and preferred stock at rates lower than will be actually incurred during the test year, provided that WPSC's authorized capital structure is consistent with the authorized debt and preferred stock rates. This does not preclude the Commission from taking other actions to prevent non-utility activities from affecting the costs of capital, including return on equity, paid by utility ratepayers.

17. WPSC's dividends to the parent holding company directly or indirectly shall be limited to no more than 103 percent of the prior year's dividends, unless modified by the Commission in a future proceeding.

18. WPSC shall file annually with the Commission (a) a report on its capital structure, (b) a ten-year financial forecast, which shall include an infrastructure investment and funding report, a capital expenditure budget, and a refinancing budget, (c) copies of analysts' credit rating reports applicable to WPSC, and (d) a financing analysis that identifies and comments upon the cost of alternative capital structure options, including alternative mixes of debt, common equity and preferred equity, consistent with maintaining the credit and bond ratings

used by the Commission to establish WPSC's equity ratio range and target in the company's most recent rate case.

Public Interest

CUB states that a public interest finding is a prerequisite to Commission approval of the proposed transaction.⁶ CUB argues that the proposed transaction is not in the public interest because the projected synergy savings are unlikely to be realized, and there are no other benefits that outweigh the considerable risks. There are risks associated with any merger. The proposed transaction has its own unique challenges; distinct and distant service territories, different operating systems, rural vs. urban service territories, predominately electric vs. predominately natural gas; distinct management and operating cultures; and different regulatory climates. There are some serious concerns involving the state of the Peoples Gas distribution system. Achieving the integration of these two corporations and the anticipated synergy savings will be a considerable challenge.

The shareholders of both WPSR and PEC have approved the merger; FERC approved the transaction; and the ICC issued an order approving the merger on February 7, 2007. The shareholders' main focus is the holding company; FERC is concerned with wholesale rates and competition; and ICC is concerned with PEC, Peoples Gas and North Shore. It is this Commission's unique and primary responsibility to protect WPSC and the public interests of the citizens of Wisconsin.

The conditions listed above reasonably protect WPSC ratepayers in all but extreme circumstances. When these conditions are coupled with the statutory authority of the

⁶ See *e.g.*, Wis. Stat. § 196.79(1)

Commission including the Commission's ability to order divestiture, or termination of interest, of the regulated utility from the holding company Wis. Stat. § 196.795(7)(c), the proposed merger can be found to be in the public interest. The Commission may order divestiture if there is clear and convincing evidence that the financial integrity of the utility would be threatened if the utility continued to be affiliated with a holding company that was experiencing financial difficulties. This remedy deals with the unexpected, and as such is an essential part of the set of conditions that protect ratepayers from experiencing undue harm from activities of the holding company and its non-Wisconsin-utility affiliates.

With the implicit incorporation of the Commission's statutory authority, the conditions and order points contained in this Final Decision are sufficient to reasonably protect the public interest and give approval to the merger transaction.

Order

1. This Final Decision shall be effective on the day following the date of mailing.
2. Other than fuel cost-related cases or adjustments for specific items identified in this Final Decision, no WPSC rate case proceedings will be entertained with a Final Decision effective date prior to 2009. Deferred accounting requests submitted by WPSC will only be authorized if they are consistent with achieving the Commission's policy objectives, including maintaining the financial integrity of the utility.
3. Any known changes in coal and rail costs may be reflected in WPSC's 2008 monitored fuel costs and the January 1, 2008, step rate changes.
4. WPSC's fuel costs shall be monitored in accordance with docket 6690-UR-118 and this docket throughout the rate restriction period.

5. Neither net merger costs nor benefits will be factored in the ROE calculation for 2007 and 2008 for the purpose of determining excess revenues under Wis. Admin. Code § PSC 116.07(6).

6. The currently-established regulatory accounting policies for WPSC's other specific regulatory accounting deferrals and amortizations shall continue to apply during the rate restriction period.

7. The applicants shall expense the cost to achieve the merger as incurred. WPSC may not recover any merger-related transaction costs, as described in the Opinion, from the Wisconsin retail jurisdiction. All transaction costs incurred by or allocated to WPSC shall be specifically identified and allocated to non-utility accounts.

8. WPSC may recover merger-related transition costs from the Wisconsin retail jurisdiction, but only if and to the extent such costs are (a) incurred by or allocated to WPSC (WPSC's portion/share of merger-related transition costs); (b) associated with financial benefits that WPSC's ratepayers will receive as a result of the merger; and (c) WPSC's merger-related savings realized are equal to or greater than its merger-related transition costs.

9. WPSC shall identify and track all merger-related transition costs incurred by it and allocated to it in a manner that is readily reviewable and auditable by the Commission at a location within Wisconsin.

10. In any proceeding in which recovery, analysis and/or justification of merger savings is at issue, WPSC shall provide a detailed analysis of merger costs and savings for Commission review and approval. The analysis shall include all of the following:

- a. An accounting of merger costs incurred by the combined company broken down by function.

- b. A calculation of merger savings accomplished by the combined company.
- c. Where costs exceeded savings for a particular function, a demonstration that the costs were reasonable and prudent.

11. The allocations of merger-related transition costs to WPSC shall be filed by WPSC and reviewed by the Commission in a separate affiliated interest docket. The Commission shall have approval authority over all allocation methodology and factors. If the allocation methodology and factors ultimately approved by the Commission differ from those approved in other jurisdictions, Integrys (the parent holding company) shall absorb any cost differentials.

12. WPSC shall maintain service quality and file any reports in this regard that may be developed or required by the Commission.

13. Within 120 days after closing, WPSC will apply for the Commission's approval under Wis. Stat. §§ 196.52 and 196.795(5)(r) and (s) of the affiliated interest transactions and agreements associated with a service company. With the application, WPSC will file its plan and schedule of operations after all federal, state, and local regulatory approvals of the service company are received. The parent holding company shall not elect to have the FERC review pursuant to Section 1275 of the Energy Policy Act of 2005, 42 U.S.C. § 16462, the allocation of costs for goods and services provided by the service company, until the Commission has reviewed and taken action on the affiliated interest transactions and agreements associated with the service company, or amendments thereto. If the Commission has not completed its review and approval within a reasonable time after the Commission determines a proposed amendment to the service company agreement complete, the parent holding company may seek such FERC review after giving the Commission 60 days' prior written notice.

14. The Commission shall have full access to the books and records of the service company as provided in Wis. Stat. §§ 196.52 and 196.795(5)(b). This access shall be readily available in Wisconsin and organized in a form acceptable to Commission staff.

15. The service company shall be limited to performing services where there are efficiencies and economies of scale that could not be achieved if the services were not performed by the service company. If, in the future, Integrys and/or any of its subsidiaries are down-sized in any significant way, the absolute cost allocation to WPSC shall not increase unless WPSC demonstrates that the cost allocation is just and reasonable. In its performance of services, the service company (a) shall follow applicable federal and state regulations, including codes and standards of conduct, with respect to the sharing of confidential information the service company receives from one subsidiary with another subsidiary; (b) shall not give one or more entities in the corporate structure a competitive advantage in relevant markets; (c) shall not subsidize WPSC or cause WPSC to subsidize an affiliate; and (d) may include a return on its net assets at a rate no higher than the prevailing weighted cost of capital for WPSC.

16. The service company may not provide services to companies that are not part of the holding company system without the Commission's approval, except that the service company may provide the services that WPSR and WPSC are currently providing to third parties (Integrys, any sub-holding companies, and WPSC may continue to provide such services until the service company is operational), and the service company may temporarily provide transition services to an entity that is transferred to a third party. The service company shall apply any earnings as a deduction to the amounts reimbursable by its associated affiliates.

17. WPSC shall file new affiliated interest agreements for new qualifying relationships and all current agreements that will have changes to the names or services after the merger. This includes, but is not limited to inter-company guarantees and lending arrangements, information sharing, technology, gas portfolios, etc.

18. Integrys Energy Group, Inc. shall be subject to all applicable requirements of Wis. Stat. ch. 196 and to all of the conditions and requirements in any Commission order relating to WPS Resources Corporation, including but not limited to the holding company formation order (docket 9405-YO-100).

19. All books and records of all entities in the corporate structure shall be readily available for Commission staff review in a reasonable manner, subject to approval by the Commission.

20. Integrys and its subsidiaries shall provide the Commission with prompt notice of any filing made with the Illinois Commerce Commission (ICC) and FERC that is relevant to the Commission's authority and obligations.

21. WPSC shall operate within its long-range common equity range, and in accordance with its common equity target, as established in its rate proceedings. No goodwill created by the merger shall be transferred to WPSC's books.

22. Integrys is subject to, among other statutory provisions, Wis. Stat. §§ 196.795(5)(g) and (5)(i), which protect utility ratepayers from the financial impacts of non-utility activities. WPSC agrees to hold ratepayers harmless from any increased costs of debt and preferred stock demonstrated to be attributable to non-utility activities. For rate setting proceedings, this may include imputing to costs of debt and preferred stock at rates lower than

will be actually incurred during the test year, provided that WPSC's authorized capital structure is consistent with the authorized debt and preferred stock rates. This does not preclude the Commission from taking other actions to prevent non-utility activities from affecting the costs of capital, including return on equity, paid by utility ratepayers.

23. WPSC's dividends to the parent holding company directly or indirectly shall be limited to no more than 103 percent of the prior year's dividends, unless modified by the Commission in a future proceeding.

24. WPSC shall file annually with the Commission (a) a report on its capital structure, (b) a ten-year financial forecast, which shall include an infrastructure investment and funding report, a capital expenditure budget, and a refinancing budget, (c) copies of analysts' credit rating reports applicable to WPSC, and (d) a financing analysis that identifies and comments upon the cost of alternative capital structure options, including alternative mixes of debt, common equity and preferred equity, consistent with maintaining the credit and bond ratings used by the Commission to establish WPSC's equity ratio range and target in the company's most recent rate case.

25. Upon the completion of the merger transactions, Integrys and WPSC shall submit all of the following to the Commission:

- a. The accounting entries recording the transactions in journal entry form with adequate explanation and supporting documentation.
- b. The accounting entries for the transfer of any assets from the utility to the holding company or non-utility affiliates. This shall include any entries to eliminate any "Advances" to the holding company or non-utility affiliates currently recorded.

26. Integrys shall prepare a market price study for each affiliated transaction activity.

The cost of such studies shall be assigned entirely to Integrys and not allocated to the WPSC.

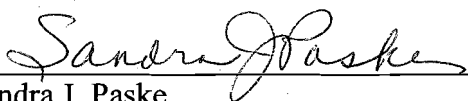
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Market price studies should be updated annually with a new study done at least every three years.

27. Jurisdiction is retained.

Dated at Madison, Wisconsin, February 16, 2007

By the Commission:


Sandra J. Paske
Secretary to the Commission

SJP:JJB:mem:g:\order\pending\9405-YI-100 Final.doc

See attached Notice of Appeal Rights

Notice of Appeal Rights

Notice is hereby given that a person aggrieved by the foregoing decision has the right to file a petition for judicial review as provided in Wis. Stat. § 227.53. The petition must be filed within 30 days after the date of mailing of this decision. That date is shown on the first page. If there is no date on the first page, the date of mailing is shown immediately above the signature line. The Public Service Commission of Wisconsin must be named as respondent in the petition for judicial review.

Notice is further given that, if the foregoing decision is an order following a proceeding which is a contested case as defined in Wis. Stat. § 227.01(3), a person aggrieved by the order has the further right to file one petition for rehearing as provided in Wis. Stat. § 227.49. The petition must be filed within 20 days of the date of mailing of this decision.

If this decision is an order after rehearing, a person aggrieved who wishes to appeal must seek judicial review rather than rehearing. A second petition for rehearing is not an option.

This general notice is for the purpose of ensuring compliance with Wis. Stat. § 227.48(2), and does not constitute a conclusion or admission that any particular party or person is necessarily aggrieved or that any particular decision or order is final or judicially reviewable.

Revised 9/28/98

DISSENTING OPINION
Commissioner Mark Meyer
9405-YI-100
February 16, 2007

I respectfully dissent from that portion of this decision as it relates to applicability of Wis. Stat. § 196.80 to this proposed transaction. The majority has interpreted the statute in a narrow fashion regarding its definition of the term “public utility”. It justifies its rationale on the decision in the Wisconsin Power and Light merger case⁷ and a declaratory ruling regarding the Commission’s jurisdiction over the Wisconsin Energy Corporation (WEC) and Esselco merger and the Wisconsin Public Service Corporation (WPSC) and Upper Peninsula Energy Corporation (UPPCO) merger.⁸ It is the majority’s belief that there are sufficient protections in place in the Wisconsin statutes and the conditions in the Final Decision and that the definition of “public utility” as set forth in Wis. Stat. § 196.01(5) as it is written and applied in conjunction with Wis. Stat. § 196.80 eliminates the statute’s applicability. However, neither of those cases is on point to the concerns raised in this merger and the protections that are necessary for Wisconsin ratepayers and WPS Resources Corporation shareholders.

The Wisconsin Power and Light merger case, while citing Wis. Stat. § 196.80 as applicable to the matter, did not discuss it. It must be remembered that the concern in that merger was addressed by the creation of 1997 Wisconsin Act 204 to allow the Iowa utilities to be deemed “foreign affiliates” for computation of the asset cap. In the WEC-Esselco and WPSC-UPPCO declaratory ruling, the Commission noted that the creation of the term “foreign

⁷ *Joint Application of WPL Holdings, Inc.*, docket 6680-UM-100, (Wis. PSC Nov. 5, 1997)

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affiliate” is defined in what is now § 196.795(6m)(a)3 for asset calculation purposes. In this matter we are not looking at the definition of public utility for asset cap purposes. The facts of those cases do not apply here.

Second, the transactions at issue in docket 3270-DR-102 differ in scale and scope when compared to the present transaction. For example, the present transaction involves changing the name and location of the headquarters of the surviving holding company; the prior transaction did not:

The Merger is to be effected pursuant to the Merger Agreement by and between WPS and UPEN. The Merger Agreement contemplates that, at the Effective Time, UPEN will be merged with and into WPS, the separate corporate existence of UPEN will cease and WPS will be the surviving corporation.

WPS Resources Corporation SEC Form S-4 August 26, 1997, *available at* <http://www.sec.gov/Archives/edgar/data/916863/0000897069-97-000368.txt>.

The combined holding company headquarters will be located in Chicago, and a new name for the combined company will be jointly selected by management from both companies. Each of the regulated utility businesses of the combined company will maintain its current name and headquarters. The non-regulated energy marketing businesses of the combined company will be headquartered in Green Bay, Wis.

WPS Resources Corporation Form 8-K July 10, 2006, Ex. 99.1.

The prior transaction, added one member to the Board of WPS Resources. The present proposal requires the creation of a new board split between the current directors of each company.

The Merger Agreement provides that the WPS Board will take such action as is necessary to increase the size of the WPS Board by one director as of the Effective Time, and that the UPEN Board will designate a person, acceptable to the WPS Board, to fill such position.

⁸ *Petition for Declaratory Ruling of MGE, Wis. Pub. Power, and Municipal Intervenors*, docket 3270-DR-102 (Wis. PSC Sept. 2, 1998)

WPS Resources Corporation SEC Form S-4 August 26, 1997.

Each company's board will choose which of its directors remain. There will be nine board members from the current WPS Resources board and seven board members from the current Peoples Energy board.

WPS Resources/Peoples Energy Announcement Employee Q&A SEC Form 425 July 9, 2006.

And while the present transaction proposes to add one million natural gas customers (nearly twice as many customers currently served by WPS Resources utility subsidiaries) to create a combined customer base of 1.67 million, the prior transaction added 43,000 retail electric customers to WPS Resources' 370,000 customers and 21,000 retail electric customers to Wisconsin Electric Corporation's 969,000. *MG&E Order*, No. 3270-DR-102, at 3-4.

In scope and size, the present transaction appears more analogous to the three-way merger of WPL Holdings, Inc., IES Industries Inc., and Interstate Power Company. WPL Holdings, Inc. was the holding company for Wisconsin Power and Light Company. IES Industries Inc. was an Iowa public utility holding company. Interstate Power Company was a utility serving portions of Illinois and Iowa. In this merger, parties sought Commission approval under Wis. Stat. §§ 196.795 and 196.80.

The transactions in the WPL Holdings merger combined, into one holding company system, Wisconsin Power and Light, serving approximately 370,000 electric utility and 140,000 natural gas customers, with two out-of-state utilities, serving approximately 700,000 electric and/or gas customers. *Joint Application of WPL Holdings*, No. 6680-UM-100, at 5-6 (Wis. PSC Nov. 5, 1997) [hereinafter *WPL Holdings Order*, No. 6680-UM-100]. Parties expected the utility subsidiaries of the combined system to serve approximately 870,000 electric customers

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and 360,000 natural gas customers in portions of Iowa, Illinois, Minnesota, and Wisconsin.

WPL Holdings, Inc. SEC Form S-4 July 7, 1996, *available at* [http://www.sec.gov/](http://www.sec.gov/Archives/edgar/data/352541/0000912057-96-014298.txt)

[Archives/edgar/data/352541/0000912057-96-014298.txt](http://www.sec.gov/Archives/edgar/data/352541/0000912057-96-014298.txt).

Like the proposed transaction, the transactions in the WPL Holdings merger changed the name of WPL Holdings, Inc., (but not its location in Madison, Wisconsin) and created a new Board of Directors.⁹

The WPLH Charter will be amended immediately prior to or upon consummation of the Mergers to, among other things, change the name of WPLH to "Interstate Energy Corporation." Interstate Energy will be the holding company for IPC or New IPC, as the case may be, and the operating subsidiaries of WPLH and IES following the Mergers. Interstate Energy will be a public utility holding company registered under the 1935 Act.

WPL Holdings, Inc. SEC Form S-4 July 7, 1996.

The Merger Agreement provides that the Interstate Energy Board of Directors . . . will, upon consummation of the Mergers, consist of fifteen persons, six of whom will be designated by WPLH, including Mr. Davis, six of whom will be designated by IES, including Mr. Liu, and three of whom will be designated by IPC, including Mr. Stoppelmoor.

WPL Holdings, Inc. SEC Form S-4 July 7, 1996.

Relying on the decision in WPL Holdings Order, No. 6680-UM-100, seems reasonable given the similarities of the present transaction to the WPL Holdings merger. However, the ruling in *MG&E Order*, No. 3270-DR-102, makes such reliance complicated, but not impossible. In *MG&E Petition*, No. 3270-DR-102, petitioners requested the Commission, based on its decision in *WPL Holdings Order*, No. 6680-UM-100, to exercise jurisdiction over the proposed transactions under Wis. Stat. §§ 196.795 and 196.80. The Commission responded by stating the order in *WPL Holdings Order*, No. 6680-UM-100, really limited the application of Wis. Stat.

⁹ The name changed to Interstate Energy which operates under the name Alliant Energy.

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§196.795 to the calculation of the asset cap under Wis. Stat. § 196.795(5)(p) (renumbered Wis. Stat. § 196.795(6m)). This decision, the Commission explained, never really approved the merger under Wis. Stat. §§ 196.795 and 196.80.

This explanation, however, appears incomplete. It fails to explain under what authority the Commission placed conditions on the formation of the holding company or the consummation of the merger, including a five-year freeze on rate increases. Wis. Stat. § 196.795(6m) says nothing to authorize such action. Furthermore, this explanation ignores the Commission's direct citation in its order to Wis. Stat. § 196.80 for such authority. *WPL Holdings Order*, No. 6680-UM-100, at 50.

The ruling in *MG&E Order*, No. 3270-DR-102, also does not necessarily bar the Commission from exercising jurisdiction in the present transaction because nothing binds the Commission to a past declaratory ruling, especially under changed context and circumstances. *Board of Regents of University of Wisconsin System v. Wisconsin Personnel Commission*, 103 Wis. 2d 545, 552, 309 N.W.2d 366, 369 (Ct. App. 1981) (Wisconsin rejects the application of the doctrine of res judicata to the proceedings of an administrative agency).

A decision of the Seventh Circuit Court of Appeals issued subsequent to the ruling in *MG&E Order*, No. 3270-DR-102 provides a final reason for departing from strictures of this ruling. In this decision the Court read a broad public purpose in and expansive powers granted to the Commission by Wis. Stat. § 196.795. The case came on a challenge of Alliant Energy to the constitutionality of a variety of sections of that statute. The Court upheld the statute in all respects except for the Wisconsin incorporation requirement of a holding company (Wis. Stat. § 196.795(5)(L)), ruling it an unreasonable burden on interstate commerce. *Alliant Energy Corp.*

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v. Bie, 330 F.3d 904, 908 (7th Cir. 2003), *cert. denied*, *Alliant Energy Corp. v. Bridge*, 540 U.S. 1105, (2004).

Two aspects of this decision support a Commission departure from its ruling in *MG&E Order*, No. 3270-DR-102, and the application of Wis. Stat. §§ 196.79, 196.795(2) and 196.80 to the present transaction. First, the Court recognized the important State interest and specialized context inherent in the regulation of utility holding company systems.

Wisconsin has a strong interest--namely the protection of the welfare of ratepayers--to be weighed against the burden the statute places on interstate trade. The need to prevent abuses made possible by the presence of a holding company is extremely important and imperative for the proper functioning of any regulatory scheme. The dangers inherent in the mere existence of utility holding companies render a great need for structural regulation of those companies. A State is entitled to regulate the financial structure and investments of companies that control utilities in that State; otherwise it would lose considerable power to police the rates charged for the provision of utility service. The burden on interstate commerce, however significant it may be, is not enough to outweigh this interest.

“[A] necessary adjunct to ensuring the protection of consumers is the authority to regulate the corporate structure of public utilities” and that holding companies provide the occasion for deceptive financing practices, nondisclosure of important corporate accounts, and the manipulation of various “service charges” by the holding companies which increase the utility’s costs and the ultimate charge to the consumer.

Alliant Energy Corp., 330 F.3d at 918, (quoting, *Baltimore Gas and Elec. Co. v. Heintz*, 760 F.2d 1408, 1424-5 (4th Cir. 1985)).

The stated interest in regulating the corporate structure of holding companies found to uphold the challenged sections of Wis. Stat. § 196.795 applies with equal force to justify the application of Wis. Stat. §§ 196.79, 196.795(2) and 196.80 to the present transaction.

This decision also supports a departure from the ruling in *MG&E Order*, No. 3270-DR-102, in another way. Despite the Commission’s statement that it did not act under

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Wis. Stat. § 196.795(2) when it approved the merger in *WPL Holdings Order*, No.

6680-UM-100, the Court determined that without approval under this section Alliant would not exist.

§ 196.795(2). This is the section specifically providing for and authorizing the formation of utility holding companies. It is by virtue of this provision that Alliant is authorized to exercise ownership and control over WPLC; to put it another way, without this provision Alliant would not exist at all as a holding company.

Alliant Energy Corp, 330 F.3d at 908.

Alliant formed out of the three-way merger of a Wisconsin holding company, an out-of-state holding company system and a separate out-of-state utility. The merger did not directly involve a public utility as defined in Wis. Stat. § 196.01(5)(a). The Court, by stating that Wis. Stat. § 196.795(2) applied to the formation of Alliant, read the term “public utility” as used in that section with the breadth necessary to effectuate the sections purpose. The same analysis should apply to Wis. Stat. § 196.80.

There are more than sufficient policy reasons for applying Wis. Stat. § 196.80 to this transaction. The statute was created so that the Commission could regulate mergers in the 1960’s and it must be interpreted in a manner that allows for the statute to evolve in its application. This is a multilayered regulatory process. There are state regulators in Wisconsin, Illinois and Michigan and federal regulators in the form of the Federal Energy Regulatory Commission and the duties it has inherited from the Securities and Exchange Commission. Each has its own parochial interest and area of expertise. What one regulator concentrates on may not interest or concern another. What one regulator sees may assist the other regulators at another juncture. This can be compared to the regulation of banking in that the state regulator will review and analyze the operations of a bank or holding company and work with the federal

regulator, the Federal Deposit Insurance Corporation (FDIC) to assure compliance and the safety and soundness of the financial institution. Unlike banking there is no fallback if something goes wrong. If a bank is failing, the FDIC is brought in and there is an organized mechanism to deal with the problem. That safety net does not exist with utilities. The state needs to have all possible avenues available to protect the ratepayers and the shareholders.

Our job as regulators is to keep the utility industry strong and vibrant in Wisconsin. Weak utilities will only translate into weak holding companies. We need to be involved when merged companies want to be involved in significant nonutility activities. What happens the next time this once merged utility decides to merge?

The Commission needs to look to the future. There will be other mergers with other fact situations. The elimination of one option now could harm our authority later. *Alliant v. Bie* has recognized the breadth of the Commission's responsibilities and the need to permit it the flexibility and discretion in protecting the public interest including that of WPSC ratepayers and shareholders. The service company that will be created in this merger is a structure that has been used before and will be used again to allow mergers to achieve synergy savings. We should use all the alternative avenues available to us to assure that our authority is not usurped in the future.



Mark Meyer
Commissioner

APPENDIX A
(CONTESTED)

In order to comply with Wis. Stat. § 227.47, the following parties who appeared before the agency are considered parties for purposes of review under Wis. Stat. § 227.53.

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(Not a party but must be served)
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